

Report of the Legislature's Joint Task Force on Ferries

*As approved by the Task Force
Members
January 15, 2001*

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Membership of the Joint Task Force on Ferries

The following Legislators served on the Joint Task Force on Ferries:

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The Legislators wish to extend their thanks to the citizen members of the Task Force:

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San Juan Ferry Advisory Committee
Inland Boatmen's Union
CEO Washington State Ferries
Kitsap Transit
Kingston Ferry Advisory Council
Pt. Townsend Ferry Advisory Council
Office of Financial Management
Clinton Ferry advisory Committee
Vashon Island Ferry Advisory Committee
San Juan County Commissioner
Association of Washington Cities
Automobile Association of America
Chair of Ferry Tariff Review Committee
Plumbers and pipe fitters union
Metro director
CEO Todd Shipyards

I. Executive Summary

In the 2000 supplemental transportation budget the Legislature created the Joint Task Force on Ferries, comprised of Legislators, citizens, ferry management and ferry workers. The Task Force was charged with reviewing the workings of the Washington State Ferry system (WSF) and answering specific questions, detailed below, regarding the recommended future direction for the system.

A. The Washington State Ferry system is an Integral Part of the State Highway System

Since 1951, the state has provided cross sound ferry service as a part of Washington's statewide network of highways. Washington Constitutional and statutory law identify the routes plied by WSF as part of the state highway system. See Washington State Constitution, Art. II, §40, RCW 47.17.735 *et. seq.*

In recent years, WSF has witnessed dramatic shifts in its funding. In 1998, the voters approved Referendum 49 (R-49) to provide additional transportation funding through bonding and by shifting additional Motor Vehicle Excise Tax (MVET) funds to transportation. In November of 1999, the voters approved Initiative 695 (I-695), which abolished the MVET. This terminated both MVET revenue and R-49 bond revenue.

Finding: The MVET provided 20% of the funding for the ferry operating program. A combination of MVET and R-49 bonds provided 82% of ferry capital funding . Beginning July 1, 2001, there are no funds in the Puget Sound Capital Construction Account. The new revenue currently earmarked for the ferry capital account during 2001-03 is not sufficient to cover existing debt service payments.

B. WSF is the Most Cost Effective Provider of Current Passenger-only Ferry Service.

During the 2000 legislative session, the Legislature considered whether ferry service could be provided by some entity other than the state.

1. *Alternative ferry service providers*

The Task force received input from providers who had considered operating the Bremerton to Seattle passenger-only ferry route.

a. Kitsap Transit Proposal

Kitsap Transit (KT) presented a proposal to take over the current Seattle to Bremerton passenger-only service provided by WSF. The Task Force conducted a detailed comparison of KTA's and WSF's financial plans. As shown by the comparative cost table below, the Task Force found WSF could provide the existing service less expensively.

**Comparative Costs of Providing Bremerton to Seattle
Passenger-only Service**

<i>Bremerton POF</i>	WSF	KTA
Annual Operating Cost	\$5,734,364	\$5,323,847
2001 - 03 Capital Cost	\$2,980,000	\$15,480,000
Total	\$8,714,364	\$20,723,847

b. Clipper Navigation

Clipper Navigation determined that taking over WSF's Bremerton to Seattle passenger-only service was not viable from a business perspective and declined to present an analysis. However, Clipper did provide information on why the private sector would probably not compete on this run:

- WSF's operating costs for both Bremerton and Southworth were reasonable;
- Private operators would have a difficult time competing and recovering operating costs, due in part to the low tariffs available

- from WSF; and
- A private operator would still require a subsidy for capital, particularly in light of the environmental costs associated with terminal construction.

Finding: After fully reviewing the input from Clipper and KTA's proposal compared to WSF's current operation, the task force determined that it was more cost effective and less risky for WSF to continue to provide the Seattle to Bremerton passenger-only service.

2. *Eagle Harbor maintenance facility*

The Task Force also examined the feasibility of alternative delivery of maintenance and preservation services. Under current law (RCW 47.28.030) Eagle Harbor must contract out projects in excess of \$50,000. Maintenance and preservation projects costing \$50,000 or less may be done using WSF employees.

Finding: WSF's maintenance and preservation facility at Eagle Harbor on Bainbridge Island is a key element in WSF's maintenance program. It provides round-the-clock maintenance and preservation service. Labor rates at Eagle Harbor are competitive with private shipyards, and many of the skills of the Eagle Harbor workforce would be difficult or impossible to find elsewhere. However, the facility is aging and needs additional investment.

C. WSF Should Increase Systemwide Farebox Recovery to 80% and Maintain the Current Level of Service.

The Task Force evaluated and made recommendations regarding different levels of farebox recovery and different levels of service.

1. *Systemwide Farebox Recovery*

The historical tariff revenue goal calls for recovery of 60% of WSF's operating costs from tariffs. This ratio, known as "farebox recovery" is currently at 62%.

A Note About Farebox Recovery

The farebox recovery percentages discussed in this report represent the percentage of operating costs, i.e. operation and maintenance of the ferry system, generated by farebox revenue. This does not include the capital costs of the system, approximately \$275 million for the 2001-03 biennium.

The WSF Tariff Policy Committee (TPC), brought several tariff policy action items to the operations subcommittee and ultimately to the full task force for consideration:

- Initiative 601 waiver: ferry tariffs cannot be significantly adjusted unless the Legislature passes a 601 Waiver;
- Time based tariff structure (tariff route equity): Relative tariffs among routes should be adjusted to reflect relative cost of operating routes calculated using standardized vessel and route assumptions to ensure fairness;
- Elasticity: If tariffs are increased ridership will decrease, thus reducing net revenue gains. Any tariff increase policy must take elasticity into account.
- Phasing: Tariff increases should be phased in over time so that WSF can at least annually examine the effects of tariff increases on ridership and on ferry-dependent communities as required by RCW 47.60.326.

Finding: It is unlikely that WSF could recover 100% of operating costs from tariffs. WSF could likely recover 80% of operating costs from tariffs.

2. Level of Service

The Legislature directed the task force to analyze and recommend: “Options for further cuts in ferry service or full or partial restoration of ferry service cuts.” Given the uncertainty of the effect of proposed tariff increases on future traffic projections, the Task Force decided to limit its service recommendation to the 2001-03 biennium.

The Task Force identified three limitations on possible alterations of the current level of service: 1) Cuts below bare bones are not viable; 2) The current level of service reflects Legislative policy; and 3) Service increases beyond the level offered prior to the 2000 legislative session are not possible with WSF’s current capital assets.

Finding: Given the parameters established above, the Task Force found that maintaining the current level of service during the 2001-03 biennium strikes a balance between the service needs of riders and WSF's current funding situation.

3. *Analysis of Operational Costs*

WSF and the tariff policy committee should consider restating ferry operating costs to exclude maintenance costs. In this way maintenance costs for the marine highway, as with maintenance costs for the land-based highway, would not be covered in full or in part by user fees.

E. An Adequate Level of Capital Investment is Necessary to Maintain and Preserve WSF's Fleet and Terminals.

The Capital Subcommittee focused on the Task Force's mandate of "establishing the short-term and long-term capital needs of the Washington state ferry system". In determining the appropriate level of capital investment, the subcommittee assumed that WSF would continue to provide the current level of service and invest in the planned projects for the Mukilteo and Anacortes terminals.

Like the rest of the highway system, the ferry system has investment priorities for capital. Those are: 1) Maintenance (covered in the operating program for ferries); 2) Preservation; and 3) Improvements. The average age of WSF's vessels is 31 years. The average age of WSF's terminals is 20 years. Those assets contain approximately 2,600 systems and structures.

The systems are divided into "category 1" (vital systems), i.e. safety related, and "category 2" (all other systems). WSF uses condition ratings to monitor and manage its systems. A condition rating is the percentage of vessel and terminal systems and structures that are operating within their life cycles. Currently category 1 systems and structures had a condition rating of 79% and category 2 have a condition rating of 66%. The subcommittee's task was to determine a prudent condition rating benchmark and to determine the cost of meeting that goal, within the context of the recommended service level.

Finding: Funding a higher condition rating on category 1 and category 2 systems would allow WSF to "catch up and keep up" to a higher level of functionality for capital systems.

F. How Much Will it Cost?

The Task Force determined what it would cost the State to offer the current level of service:

1. Extent of the shortfall

The primary ongoing revenue sources for WSF are:

**Current Statutory Sources of Ferry Revenue
With Projected Amounts for the 2001-03 Biennium**
in millions

	Gas Tax	Tariffs	Registration fees	Federal Funds	Total
Projected 01-03 revenue for Operations	\$34.1	\$198.9	\$12.5		\$245.7
Projected 01-03 revenue for Capital	\$35.7	N/A	N/A	\$40.3	\$75.5

Total appropriation required for ferry operations and capital in 2001-03:

- Operations: \$344 million;
- Capital: \$275 million.

Finding: The additional funding necessary to maintain the current level of service 2001-03 biennium, after accounting for current dedicated funding:

- \$44 - 84 million for operating depending on the amount transferred from the general fund; and
- \$197 million for capital.

2. Additional Sources of Revenue.

The possible responses to the revenue shortfall can be divided into two general categories: decrease expenses or increase revenue.

a. *Decrease Costs*

WSF has decreased expenses, cut staff, and implemented efficiencies due to the revenue shortfall caused by the loss of the MVET and based upon potential efficiencies identified in the 1998 Joint Legislative Audit and Review Committee performance audit.

Finding: WSF must strive to achieve further efficiencies, but further savings of the magnitude necessary to significantly address the shortfall are not feasible.

b. *Increase Revenue*

WSF has the ability to raise more revenue through tariff increases. The figures identifying the shortfall provided above assume additional tariff revenue. The task force found that WSF could raise a significant amount of additional revenue through tariffs, as detailed below:

**Revenue from Proposed Tariff Increases Moving to 80%
Farebox Recovery and Incorporating Time based tariff structure
(tariff route equity)**

rate of accrual may vary depending upon how increases are phased in
(In thousands)

	2001-03	2003-05	2005-07
New revenue - auto	\$21,987	\$52,051	\$77,957
New Revenue - POF	\$ 2,941	\$ 4,330	\$ 5,656
Total	\$24,928	\$56,381	\$83,613

Finding: The significant revenue increases available through the potential tariff increases are not sufficient to cover the operating shortfall.

G. Governance

Finding: The Task Force identified the governance of the ferry system as an issue worthy of further study.

II. Summary of The Recommendations of the Joint Task Force on Ferries

After fully reviewing and discussing the information presented, the Joint Task Force on Ferries voted to present a slate of recommendations to the Legislature. Those recommendations are summarized below and discussed in greater detail in the body of the report.

1. **Ferries are part of the state's highway system and should remain open.** Washington law, in both the State Constitution and in statute, identifies the state operated ferry system as a part of the state's highway system. As with the other links in the state highway system, no currently operated ferry routes should be terminated.
2. **The state should continue to provide and maintain both auto ferry and passenger-only ferry service.**
 - a. Alternative service providers are not able to offer the current level of service as cost effectively as the state, in part because of the need for significant capital investment.
 - b. If an alternative service provider offered Puget Sound ferry service, the entity would require a significant level of subsidy.
 - c. State-local or public-private partnerships may be a viable option if the Legislature wishes to explore expansion of the passenger-only program at some future date.
3. **WSF should maintain an in-house maintenance and preservation facility.** The Eagle Harbor maintenance and repair facility provides irreplaceable 24-7 coverage for ferry and terminal maintenance needs. The need for in-house support of maintenance is clear.

4. The majority of ferry users recognize the need to pay a greater share of operating costs. The Legislature should pass a waiver of I-601 for ferry tariffs so that the Transportation Commission can phase in tariff increases that will: (a) raise farebox recovery to 80% of operating costs over six years; (b) result in passenger-only tariffs set at double the level for passengers on the auto ferries by May of 2001; and (c) implement a journey time-based model of time based tariff structure (tariff route equity).

- a. Under current law ferry tariffs cannot be raised by more than the I-601 fiscal growth factor. By passing a permanent I-601 exemption in the first part of the 2001 session, the Legislature would enable the Commission to begin phasing in the recommended tariff increases in time for the summer 2001 season.
- b. Raising tariffs over the next six years in an amount sufficient to generate 80% of the systemwide operating costs would significantly increase the share of operating costs paid by the users.
- c. Currently, passenger-only tariffs cover 30% of their portion of the systems operating costs. Doubling passenger-only tariffs by June 2001 and then increasing them on the same schedule as auto tariffs will achieve farebox recovery comparable to the auto ferries. Such an increase should be reviewed periodically and reconsidered if:
 - i. The ridership drop due to elasticity threatens viability of the program; or
 - ii. The Bremerton passenger-only ferries are no longer allowed to run at high speed.
- d. Implementing the ferry tariff policy committee's time based tariff structure (tariff route equity) proposal would address long-standing equity issues between routes. Adjusting tariffs to be more equitable across routes is an important part of any tariff increase program.

5. Ferries should continue to provide the reduced level of service funded in the 1999-01 supplemental budget through the 2001-03 biennium, including passenger-only service.

- a. Following the repeal of the MVET, the Legislature cut funding for

auto and passenger-only ferry service. In response to the cuts, WSF reduced service to the level prescribed by the Legislature.

- b. If the Legislature considers restoring any of the service eliminated during the last legislative session, restoration of the Pt. Townsend - Keystone and Pt. Defiance - Talequah cuts would be the most cost-effective.
- c. The operating program cost of providing the current level of service through the 01-03 biennium is \$344 million. Approximately \$199 million of that amount is generated from user fees in the form of tariffs. After taking into account current tariff levels and other projected revenue, approximately \$44 million in operating costs to come from other revenue sources. Significant capital program costs are in addition to this amount.
- d. Future service needs should be reevaluated once WSF is able to more accurately assess the impact of tariff increases on ridership.

6. Short-term and long-term capital preservation requirements should be met in order to ensure the delivery of operating services. The Legislature should fund ferry capital program to a level that allows the ferry system to catch-up and keep-up with deferred life-cycle preservation and maintenance needs and replace aging vessels and terminals as needed.

- a. Current life cycle preservation activities do not address the replacement of assets as they reach the end of their service life.
 - i. Replacement of certain existing terminals and vessels is essential to maintaining current operating services into the future.
 - ii. New vessel and terminal construction takes many years to accomplish. For example, in order to have new vessels ready when needed, the state would need to launch the eight year vessel procurement process during the 01-03 biennium. Major terminal construction takes even longer.
- b. “Catching up and keeping up” with ferry and terminal preservation and maintenance needs means:
 - i. Raising the condition rating for Coast Guard regulated

capital systems to between 90% and 100% by 2011. The condition rating for those systems was at 79% at the beginning of the 1999-01 biennium.

- ii. Raising other systems' condition ratings to 70% by the 2011 planning period. The condition rating for those systems was at 66% at the beginning of the 1999-01 biennium.
- c. Meeting these goals and existing debt obligations will require \$275 million in the 2001-03 biennium and an average of \$346 million per biennium. This is in addition to the \$344 million operating cost identified in no. 5, above.
 - i. Preservation of existing facilities: \$167 to \$225 million per biennium.
 - ii. Replace four auto ferries scheduled for retirement: \$63 million per biennium.
 - iii. The Mulkilteo and Anacortes terminal projects that address preservation and multimodal needs: \$7 million in the 2001-03 biennium with a \$41 million per biennium ten-year average.
 - iv. Replacement of two aging passenger-only boats with one new boat during the 01-03 biennium with no loss of service.
 - v. New construction to replace vessels and terminals is expected to eliminate the need for \$38 million in preservation costs.
 - vi. The WSF maintenance and repair facility is in need of additional investment. During the 2001 interim, WSF should review the Eagle Harbor facility and present investment options and recommendations to the 2002 Legislature.

7. The state needs to do a better job of telling citizens what they are getting for their ferry operating and capital investments.

- a. Display ferry capital investments in the same format and in the same location as WSDOT highway projects.
 - i. Format the presentations under maintenance, operations, preservation and improvements.
 - ii. Include ferry capital reporting in the transportation executive information system used by the Legislature.
 - iii. Present information in a performance based budgeting

module similar to that used by WSDOT's maintenance accountability program.

- b. Increase information available to the public.

8. Washington State Ferries must continue to adopt operational efficiencies. Implementing further efficiencies includes:

- a. Continuing to implement efficiencies proposed in the 1998 Joint Legislative Audit and Review committee's performance audit; and
- b. Investing in the technology needed to enable WSF to implement time-of-day and day-of-week variable tariffs.

9. The Legislature should review ferry governance options. Possibilities include:

- a. The creation of local or regional ferry transit districts as a funding mechanism for the expansion of passenger-only ferry service; and
- b. Once the Legislature establishes a predictable continuing funding base for the state ferry system, the Legislature should examine options for ferry governance as part of the overall review of transportation governance recommended by the Blue Ribbon Commission on Transportation.

III. Introduction: Washington State Ferries - An Integral Part of the State Highway System

A. The History of Ferry Service on Puget Sound

Prior to 1951, Washington State did not provide ferry service for its citizens. Beginning in the early 1900s, Puget Sound ferry service was initially provided by a number of companies using small steamers known as the “Mosquito Fleet”. By 1929, the ferry industry had consolidated into two companies: The Puget Sound Navigation Company and the Kitsap County Transportation Company. A strike in 1935 forced the Kitsap County Transportation Company out of business and left the Puget Sound Navigation Company, commonly known as the Black Ball line, with the primary control of ferry service on Puget Sound.

After World War II, increasing operating costs made private operation of the ferry system increasingly challenging. In the late 1940s, ferry workers’ labor unions secured higher wages from Black Ball. Black Ball petitioned the state highway department to allow a 30% tariff increase to meet the new operating costs. When the State refused the request, Black Ball tied up its boats, bringing much of the cross-sound ferry service to a halt.

Washington State recognized that the ferries were a lifeline for many communities and that there was a need for reliable ferry service to meet growing demand. In 1951, after numerous discussions with the State Legislature over tariffs and service, Black Ball sold off its Puget Sound terminal facilities and ferries for \$5 million to a newly created Washington Toll Bridge Authority, now known as Washington State Ferries (WSF).

The ferry system was originally intended to provide temporary service until a network of bridges could be built connecting the west and east sides of

Puget Sound. In 1959, however, the legislature rejected the plan to build numerous cross-sound bridges. From that time forward, the state has provided cross sound ferry service as a part of Washington's statewide network of highways.

The 18th amendment to the Washington State Constitution, Art. II, §40 identifies the ferries are part of the state highway system. Under that provision of the Constitution, gas tax moneys collected by the state may only be spent for "highway purposes." Highway purposes were defined to include: "...operation of ferries which are part of any public highway, county road or city street."

The Legislature has expressly identified the ferry routes plied by WSF as state highways by designating those routes as a continuation of the highway that leads up to the dock. For instance, the Mukilteo/Clinton ferry route is designated as a portion of SR 525, *see* RCW 47.17.735.

B. Financial History of WSF

When the state purchased the ferry system from Black Ball it expected the system to finance itself solely through the fare box. The ferry routes sustained revenues in excess of operating expenses until 1960. The entire ferry/bridge system generated net revenue until 1974 because of the financial success of the Hood Canal toll bridge.

Farebox revenue continues to play an important part in providing funding for the WSF. The Transportation Commission has set a target requiring farebox revenue to cover at least 60% of the operating expenses for the ferry system. In fiscal years 1998 and 1999, the ferry system generated revenue to cover 65% and 66% of its operating costs, respectively. So far in fiscal year 2001, in part due to a spike in fuel prices, WSF is recovering 62% of its operating costs from the farebox.

In 1957, the state began providing tax revenue to the ferry system supplementing farebox revenue. That support has increased over time as the system has grown to meet demand. Since the 1970s, State revenue sources have included the gasoline tax, motor vehicle excise tax, and motor vehicle registration fees. In addition WSF pursues federal and local funds for specific projects.

In 1998, the voters approved Referendum 49 (R-49). This referendum provided additional funding for Washington State's Transportation System by transferring additional funding from the Motor Vehicle Excise Tax (MVET). The

1999-01 budget appropriated \$286,720,000 to the ferry capital program, including \$110,729,000 from the proceeds of Referendum 49 bonds. Based upon projected growth in ridership and the policy decision to expand the passenger- only program, WSF was positioned to provide expanded service as well as tend to existing capital needs of the system.

In November of 1999, the voters approved Initiative 695 (I-695), which abolished the Motor Vehicle Excise Tax (MVET). Although I-695 was later declared unconstitutional by the state Supreme Court, the Legislature separately enacted and preserved the abolition of the MVET. The elimination of the MVET also constrained the revenue source that intended to pay for the R-49 bonds. The net result was that the state's transportation system lost both the MVET revenue and the R-49 bond revenue.

Under the 1999-01 budget passed by the Legislature prior to I-695, the ferry system was heavily dependent on MVET revenue. The MVET represented 20% of total ferry operating revenues. 82% of the capital program funding came from a combination of MVET revenue and referendum 49 bond proceeds. With the passage of I-695, those funds evaporated.

Prior to I-695's passage the Puget Sound Ferry Operations Account had a fund balance of approximately \$110 million in the Puget Sound Ferry Operations Account. Those funds were primarily intended to help finance the expansion of passenger-only service. With the passage of I-695, plans for passenger only ferry expansion were shelved. Instead, the fund balance was used to partially backfill for the loss of funds caused by the passage of the initiative. This, along with cuts in ferry service, overhead and the capital program, provided sufficient funding to keep the ferry system operating until June 30, 2001.

Beginning July 1, 2001, there are no funds in the Puget Sound Capital Construction Account.. The new revenue currently earmarked for the ferry capital account during 2001-03 is not sufficient to cover existing debt service payments..

C. The Joint Task Force on Ferries

At the same time it provided ferry funding through June 30, 2001, the Legislature formed the Joint Task Force on Ferries to assist it in determining what to do with the ferry system after that date. The task force includes members of the following groups:

- Legislators from both ferry and non-ferry districts;
- Members of ferry advisory committees;

- Non-ferry users;
- Ferry union representatives;
- WSF;
- Transit operators;
- The Governor's office of financial management;
- Private maritime industry; and
- Tourism industry.

The Legislature charged the task force with reporting back to the full Legislature with recommendations on the following topics:

1. Establishing a goal for farebox recovery;
2. Options for different levels of service;
3. Feasibility of privatization, public-private partnerships or state and local partnerships; and
4. Establishing the short-term and long-term capital needs of the system.

The task force met over the 2000 interim to examine those questions and arrive at the recommendations contained in this report. This report began with a summary of the task force recommendations. A more detailed discussion of the reasoning behind those recommendations follows.

D. Recommendation

1. **Ferries are part of the state's highway system and should remain open.** Washington law, in both the State Constitution and in statute, identifies the state operated ferry system as a part of the state's highway system. As with the other links in the state highway system, no currently operated ferry routes should be terminated.

IV. Alternatives for Delivery of Ferry Service

During the 2000 session, the Legislature considered whether ferry service could be provided by some entity other than the state. Privatization of ferry routes or services, public-private partnerships or state-local partnerships were all proposed in bills introduced during the 2000 legislative session¹.

With the exception of HB 2959, the proposals focused on the passenger-only program. This was due in part to the Transportation Commission's post I-695 budget calling for the elimination of that program. Taking its cue from the Legislature, the Task Force's Service Delivery Options Subcommittee concentrated its examination of the viability of alternative service delivery models for the passenger-only system. The Task Force did, however, explore possible privatization of auto ferries and/or terminals. Unlike the passenger-only program, no provider expressed any interest in assuming on any part of the auto ferry or terminal services currently provided by WSF.

Under current law, statutory obstacles exist that would hamper the ability of another operator to provide service currently provided by WSF:

- Ten mile Rule (RCW 47.60.120). No provider may operate a ferry service within a ten mile radius of a route currently offered by WSF unless the operator receives a franchise from WSDOT or a waiver from the Utilities and Transportation Commission.
- Assumption of labor agreement obligations (RCW 47.64.090). Any party renting, leasing, or chartering a ferry from WSF must operate under WSF labor agreements.

¹See SB 6131, 6477, HB 2937, 2950, 2974.

- Contracting out prohibition (RCW 41.06.380) The state cannot contract out for labor if the contract would have the effect of terminating classified employees.

Any alternative service provider would either have to work within the parameters of the existing statutes or seek a statutory change through the Legislature.

The task force evaluated a detailed proposal from the Kitsap Transit (KT) for providing passenger-only service. A private provider, Clipper Navigation, also looked at the possibility of providing passenger-only services. Finally, the task force looked at WSF's Eagle Harbor maintenance and preservation facility to evaluate possible alternative approaches to delivering those services.

A. Kitsap Transit Proposal

The proposal submitted by KT focused on providing service over and above that currently offered by WSF. Specifically, KT proposed opening new passenger-only ferry service from Southworth and Kingston to Seattle. KT would have run the Seattle to Bremerton service as a contract service. This contract proposal is the basis comparison in this report.

Both KT and WSF worked closely with legislative staff to develop cost comparison numbers for evaluating the relative cost effectiveness of the service providers. Because KT does not currently operate a ferry service, its estimates involved a number of assumptions that would have to be verified before authorization of KT to move forward with its proposal to provide passenger-only service.

The final cost comparison indicated that, based upon the assumptions used, KT could provide the level of service for somewhat lower operating costs coupled with higher capital costs, as detailed in the table below:

**Comparative Costs of Providing Bremerton to Seattle
Passenger-only service**

	WSF	KT
Annual Operating Cost	\$5,734,364	\$5,323,847
2001 - 03 Capital Cost	\$2,980,000	\$15,480,000
Total	\$8,714,364	\$20,723,847

There were several key differences between the KT proposal and the current service offered by WSF. KT proposed:

1. *A larger fleet of smaller boats.*

WSF provides the current passenger-only service between Seattle and Bremerton using two 350 passenger fast ferries, the Chinook and the Snohomish. KT's proposal calls for using five 149 passenger boats to deliver the same service. The smaller boats would have the advantage of a smaller wake and the flexibility to vary capacity at different times of the day based upon ridership. Disadvantages include staging problems with arrivals and departures of additional vessels, \$12.5 million in additional resources to build the boats, and a one-year wait for delivery of vessels.

2. *Lower wages and smaller crews*

Using KT boats would allow KT's contractor to pay lower wages than those currently bargained by WSF, assuming that the contractor's labor force belonged to a different union than WSF's.

KT's proposal for smaller boats would allow for smaller crews, although it is not completely clear how small. This level of uncertainty is due in part to the role of the U.S. Coast Guard in certifying vessels. KT's proposal calls for a three member crew on the 149 passenger boats. The Coast Guard may or may not approve that level as adequate. KT's director acknowledged the uncertainty and stated that his preference was for a four member crew, which would drive KT's operating costs to a point slightly higher than WSFs.

KT's assumption of smaller crews and lower wages allows for a significantly lower hourly cost per boat. This is offset somewhat by the need to run more boats at peak hour under the KT proposal. Detail on the differences between WSF's current wage and crew size and that proposed by KT is provided below:

Comparative Wages and Crew Sizes

	Base Hourly Pay Rate		Crew Configuration	
	WSF	KT	WSF (350 pax)	KT (149 pax)
Master	\$35.79	\$29.73	1	1
Mate	\$27.40	N/A	1	0
AB	\$19.76	N/A	1	0
OS	\$17.58	\$10.25	1	1
Assistant Eng.	\$26.63	N/A	1	0
Gen. purpose merchant naval officer	N/A	\$18.45	0	1
Totals	\$125.16	\$58.43	5	3

After fully reviewing KT's proposal compared to WSF's current operation, the task force determined that it was more cost effective and less risky for WSF to continue to provide the Seattle to Bremerton passenger-only service rather than KT.

B. Clipper Navigation

The President of Clipper Navigation participated as a member of the task force. Mr. Darell Bryan, who sat on the service delivery options subcommittee, evaluated whether Clipper could run the Seattle to Bremerton passenger-only service as a viable business venture. Clipper began with the cost comparison template developed to compare the KT proposal to the WSF program. After some preliminary review, Clipper determined that the service was not viable from a business perspective and declined to present a formal analysis.

Clipper did provide some insights that could affect the interest of a private operator in formulating a proposal to assume the current passenger-only operation. Clipper noted that:

- WSF's operating costs for both Bremerton and Southworth were reasonable;

- Private operators would have a difficult time competing and recovering operating costs, due in part to the low tariffs available from WSF; and
- A private operator would still require a subsidy for capital, particularly in light of the environmental costs associated with terminal construction.

Based upon the information from Clipper, the task force determined that privatization of the current service was probably not a viable option.

C. Expanded Service

Prior to the passage of I-695 the Legislature funded an expanded passenger-only ferry service program. The proposed expansion would have created new passenger-only ferry service from Southworth and Kingston to Seattle. The vessel acquisition and terminal construction required for WSF's program would require a capital investment of approximately \$161 million over six years..

In the current budget environment, such an investment is unlikely. The KT proposal for providing the expanded service was less expensive with \$82.5 million in capital costs (assuming peak hour service only in Kingston). Under KT's analysis, it could operate Kingston peak hour service for \$1.3 million per year less than WSF. In the event that the Legislature decides to consider passenger-only service expansion in the service, it may be a viable option to consider a state-local or public-private partnership such as that proposed by KT.

D. Eagle Harbor

WSF's maintenance and preservation facility at Eagle Harbor on Bainbridge Island is a key element in WSF's maintenance program. It supports annual vessel lay-up periods, emergency vessel and terminal repairs, preventive maintenance and other maintenance needs. In fiscal year 2000, Eagle Harbor accounted for more than 60% of WSF's total maintenance expenditures. Under RCW 47.28.030 Eagle Harbor must contract out projects in excess of \$50,000. Accordingly, the balance of the maintenance is completed by contractors, outsourced labor, and in some cases, WSF engineering staff. A recent performance audit sponsored by the Joint Legislative Audit and Review Committee (JLARC) found that Eagle Harbor's cost of labor is comparable to private shipyards and facilities.

Eagle Harbor is staffed seven days a week, 24 hours a day, 365 days a year. Access to immediate maintenance and preservation staff is crucial for an operation with a large and aging array of vessels and terminals. Eagle Harbor has successfully retained staff and built a work force with a unique set of

knowledge and skills specific to WSF's fleet. For instance, there are nine manufacturers and 20 different models represented in WSF's 180 diesel engines used to power the fleet. Some of the equipment is no longer supported by the original vendor. However, Eagle Harbor's workforce is uniquely qualified to handle the challenges presented by WSF's vessels and terminals. One seemingly paradoxical result is that some of WSF's oldest vessels, the steel electric class built in 1927, have some of the best performance records.

The service delivery options subcommittee toured Eagle Harbor and noted issues with the aging facility. The site was originally built as a shipyard for the construction of sailing ships. The main building, which predates the 1940s, is constructed of wood and partially situated on wood pilings. On the tour, subcommittee members were shown where a lathe had fallen through the floor, which had to be reinforced before the lathe could be reinstalled. Following this incident, WSF determined that it was no longer safe to drive fork lifts into the building. Heavy loads are now handtrucked in, decreasing efficiency and highlighting the dilapidated state of the building.

E. Recommendations

2. The State Should Continue to Provide Both Auto Ferry and Passenger-Only Ferry Service. Providing ferry service is a capital intensive undertaking. Neither private industry nor local governments have the infrastructure to provide ferry service in a cost-effective manner. The cost of developing that infrastructure would be a duplicative expenditure given that the state already possesses the infrastructure. The state is the lowest cost, most dependable provider of ferry services for Washington State.

- a. Alternative service providers are not able to offer the current level of service as cost effectively as the state, in part because of the need for significant capital investment.
- b. If an alternative service provider offered Puget Sound ferry service, the entity would require some level of subsidy.
- c. State-local or public-private partnerships may be a viable option if the Legislature wishes to explore expansion of the passenger-only program at some future date.

3. WSF should maintain an in-house maintenance and preservation facility. The Eagle Harbor maintenance and repair facility provides irreplaceable 24-hours-a-day/seven-days-a-week coverage for ferry and

terminal maintenance needs. The need for in-house support of maintenance is clear and Eagle Harbor effectively meets that need.

V. Operations - Service & Farebox Recovery

A second subcommittee of the JTFF was assigned the task of evaluating and drafting recommendations regarding WSF operations. Specifically, the subcommittee was charged with developing a recommendation for a level of farebox recovery and a level of service given the budget shortfall facing WSF after the loss of the MVET revenue.

Currently WSF provides ferry service on the following routes:

Route Lengths and Crossing Times

Route	Nautical Miles	Statute Miles	Approximate Crossing Time
Anacortes/Sidney B.C. via Upright channel	34.7	39.9	3.25 hr.
Via Wasp Pass	36.7	31.9	3 hr.
Anacortes/Friday Harbor (via Lopez)	15.8	18.2	1 hr. 35 min.
Anacortes/Orcas	12.4	14.3	1 hr. 15 min.
Anacortes/Lopez	9.4	10.8	50 min.
Seattle/Bremerton (auto ferry) (Passenger-only)	13.5 "	15.5 "	1 hr. 30 min.
Seattle/Bainbridge Island	7.5	8.6	35 min.
Seattle/Vashon (passenger-only)	8.5	9.8	30 min.
Fauntleroy/Southworth (via Vashon Island)	4.4 4.1	5.1 4.7	45 min. 35 min.
Fauntleroy/Vashon	2.8	3.2	15 min.
Vashon/Southworth	1.6	1.8	10 min.
Point Defiance/Tahlequah	1.5	1.7	15 min.
Port Townsend/Keystone	4.3	4.9	30 min.
Mukilteo/Clinton	2.3	2.5	20 min.
Edmonds/Kingston	4.5	5.2	30 min.

A. Farebox Recovery

The primary ongoing revenue sources for the WSF operations program are tariffs, registration fees and a dedicated portion of the fuel tax. Of those sources, the largest single source of revenue is tariffs. The historical target set by the transportation commission calls for recovery of 60% of WSF's operating costs from tariffs (100% on the Anacortes-Sidney route). This ratio, known as "farebox recovery" is currently a little over the target at 62%. One of the duties assigned to the task force was to evaluate the level of farebox recovery and recommend a new level.

A Note About Farebox Recovery

The farebox recovery percentages discussed in this report represent the percentage of operating costs, i.e. operation and maintenance of the ferry system, generated by farebox revenue. This does not include the capital costs of the system. Those costs are currently estimated at \$275 million for the 2001-03 biennium.

The WSF Tariff Policy Committee (TPC), with the help of consultants Berk and Associates, had already started the data analysis that was crucial to developing a coherent tariff policy. The TPC brought several action items to the operations subcommittee and ultimately to the full task force for consideration.

1. Initiative 601 Waiver

In 1993 the people of Washington passed Initiative 601 (I-601) which has a provision limiting the growth of fees imposed by the state. This "I-601 limit", is calculated based upon increases in inflation and state population, see RCW 43.135.055. This factor currently limits ferry tariff increases to 2.7% annually.

I-601, by its terms, authorized the Legislature to identify particular fees that, in its judgement, should not be subject to the 601 limit and to exempt them. In the opinion of the attorney general's office, ferry tariffs are a "fee" under RCW 43.135.055. Consistent with that opinion, legislative approval would be required in order to raise ferry tariffs in excess of the I-601 limit.

In the past the Legislature has authorized the Transportation Commission to increase ferry tariffs in excess of the fiscal growth factor. Such a provision was included in the 1998 supplemental transportation budget (Chapter 348, Laws of 1998). Because the authorization was in a budget bill, it was only effective for the 1998 and 1999 fiscal years. The Legislature has passed permanent I-601 waivers in other situations, see RCW 46.16.063

Any discussion that posits an increase in farebox recovery or the accomplishment of other policy goals through tariff policy is conditioned upon obtaining an I-601 waiver from the Legislature.

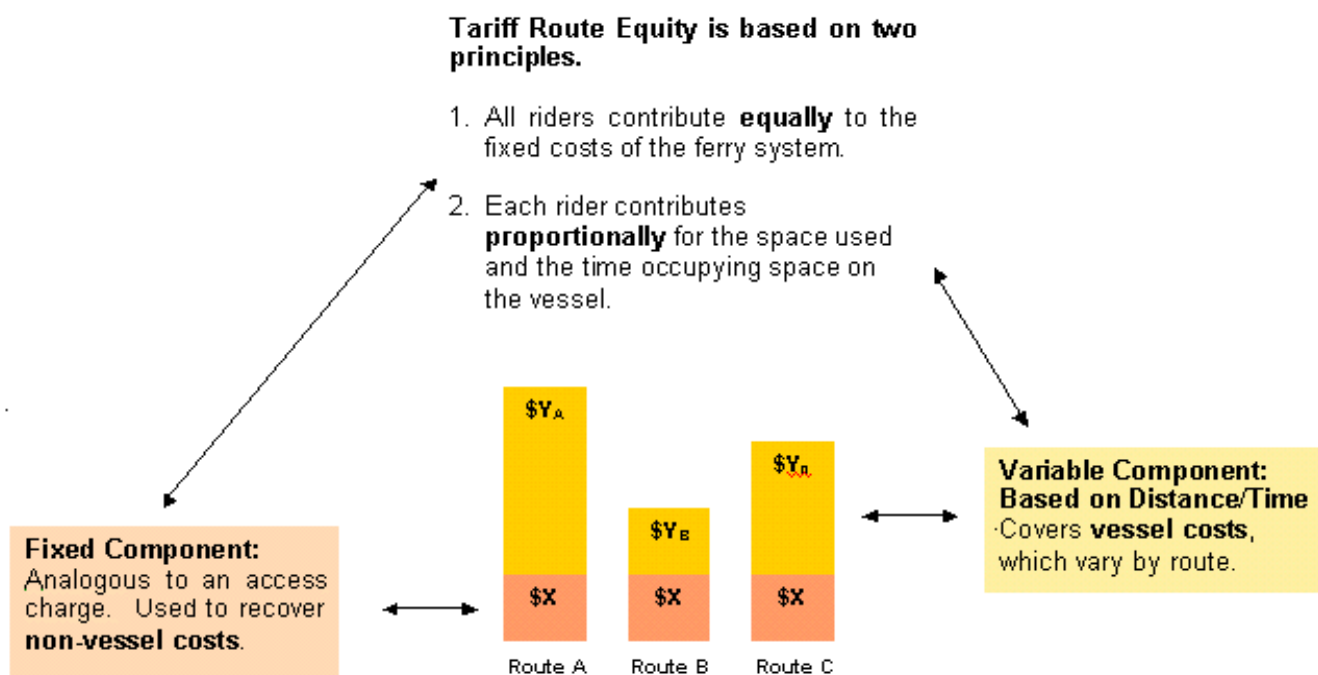
2. *Time based tariff structure (tariff route equity)*

Time based tariff structure (tariff route equity) is the relationship of tariffs among routes. Current tariff relationships and route groups have been based on the tariff structure WSF inherited from the Black Ball system in 1951 with the exception of the “cube concept” assessing a higher tariff for over-length or over-height vehicles.

There is no policy rationale for the current relationship among tariffs on routes of different lengths. For instance, Fauntleroy-Vashon pays \$2.50 round trip per full fare passenger, Fauntleroy-Southworth pays \$3.70 - that's 48% more for an additional 5 minutes of crossing time. Long-standing customer concern and confusion has existed about the relationship of tariffs among routes.

The TPC has examined the time based tariff structure (tariff route equity) issue at length and proposed a solution. TPC's proposal adjusts ferry pricing between routes so that the tariff charged bears more of a relationship to the operating cost of the route, as detailed below:

Tariffs need to recover both fixed and variable costs



The task force agreed that implementation of time based tariff structure (tariff route equity) should be part of the tariff policy recommended by the task force.

3. *Elasticity*

Another issue to consider in setting tariff policy is demand elasticity. Elasticity is a measure of the estimated ridership response to a tariff increase. If tariffs are increased, revenue per rider will increase, but ridership is expected to decrease. The net result: a 20% increase in tariffs yields less than a 20% increase in revenue.

WSF has never implemented a tariff increase of a magnitude sufficient to effect a discernible decrease in ridership. Accordingly, there is no reliable data on which to base a prediction of how much ridership will decrease in response to significant tariff increases. For this reason the TPC recommends phasing in tariff increases over time.

Phasing will lessen the reduction in ridership, thus mitigating elasticity. It also mitigates the impact of tariff increases on ferry-dependent communities, giving them time to adjust. Finally, phasing will allow WSF to gather data on elasticity in a unique market and avoid the paradox of losing money by raising tariffs, i.e. revenue lost from decrease in ridership exceeds revenue gained from the increase.

WSF and the TPC have attempted to construct useful elasticity assumptions for use in setting farebox policy. Some argue that those assumptions are too conservative, others that they are not conservative enough. Actual market experience will determine which range of assumptions is right. In the meantime, the task force has used WSF's elasticity assumptions as a starting point.

Based upon those assumptions, it appears feasible to recover up to 80% of WSF's operating budget through farebox collections. It appears that, due to a reduction in ridership, a higher target may be difficult to attain in the next six years because of the tariff increases required. For instance, WSF posits that moving from the current 60% farebox recovery to 80% would require total systemwide increases of 92% over 6 years. In contrast, moving to 90% farebox recovery would require total systemwide increases of 126%.

4. *Tariff policy issues unique to the passenger-only program*

Up to this point, the tariff discussion has dealt with the system as a whole,

both auto and passenger-only ferries (POF). The Task Force also identified farebox recovery issues unique to the passenger-only program.

The passenger only program has been greatly enhanced by the addition of two new fast boats in the last three years. This upgrade resulted in better service for Bremerton and enabled the ferries to continue to offer a passenger-only run from Vashon Island to downtown Seattle. The tariffs for this premium service are the same as passenger tariffs on the slower auto boats. Farebox recovery for these runs, however, is much lower than the farebox recovery for the auto ferry service.

The TPC voted to recommend that tariffs for the passenger-only service be raised to double the tariffs for passengers on the slower auto boats. This recommendation was based upon comparison with passenger-only tariffs charged by other systems and comparison of farebox recovery between WSF's auto ferries and passenger-only ferries.

Setting passenger-only fares at twice the applicable auto passenger fare would mean that a commuter using a coupon book, the majority of riders, would see their round-trip tariffs increase significantly from the current level of \$2.60. In considering this course of action the task force looked at tariffs charged by other passenger-only ferry services in the U.S.

Tariffs Charged by U.S. Passenger-Only Ferries

Service	Crossing time	Roundtrip Tariff
Alameda/Oakland	15-20 minutes	\$9.60
Harbor Bay Isle	25 minutes	\$9.60
Larkspur	30 minutes	\$5.90
Sausalito	30 minutes	\$10.00
New Jersey/Manhattan	11 routes, crossing time varies	\$4.00 - \$12.00
N.J./Manhattan & Brooklyn/Manhattan	45 minutes	\$22.00 - \$32.00
N.J./Manhattan	40-55 minutes	\$20.00 - \$27.00
WSF	30 minutes	\$2.60-\$3.70

Nationwide, the average round-trip passenger-only tariff is \$15.00. The median tariff is \$10.00. WSF passenger-only tariffs fall below either level.

Another consideration in evaluating a differential passenger-only tariff was the relative farebox recovery of the passenger-only program as compared to the system as a whole. Current farebox recovery for the entire system is hovering around 60%. In contrast, farebox recovery for the passenger-only system is at 30%. During discussions surrounding cancelling the passenger-only program during the 2000 legislative session, the low level of farebox recovery was often cited as a reason for reevaluating the viability of the program. Increasing the passenger-only tariffs to double that charged on applicable auto ferries would bring farebox recovery for in-line with the rest of the system.

5. *Determining operating costs.*

In calculating rates of farebox recovery, the JTFF used the current definition of “operating costs” used by WSF, which includes maintenance costs. Members of the task force expressed interest in examining whether it was appropriate to include maintenance as part of the costs to be offset by user fees. The task force asked WSF to consider restating ferry operating costs to exclude maintenance costs. In this way maintenance costs for the marine highway, as with maintenance costs for the land-based highway, would not be covered in full or in part by user fees.

B. Tariff Recommendations

4a. The Legislature Should Exempt Ferry Tariffs from the I-601 Fiscal Growth Factor Limitation.

The Transportation Commission cannot adopt tariff increases that would increase farebox recovery or implement time based tariff structure (tariff route equity) unless ferry tariffs are exempted from the fiscal growth factor limitations of RCW 43.135.055 (I-601). The Legislature should utilize the mechanism provided by I-601 to exempt ferry tariffs from the I-601 limitations.

- a. The exemption should be passed in a separate bill rather than a budget bill and made permanent codified law.
- b. The Legislature should expedite passage of the exemption so that the Governor can sign it by late February or early March. This will allow the transportation commission to adopt new tariffs in time for the 2001 summer season.

4b. The Transportation Commission Should Implement the Ferry Tariff Committee's Time based tariff structure (tariff route equity) Proposal.

The Joint Task Force on Ferries should adopt the TPC's Time based tariff structure (tariff route equity) proposal. The Time based tariff structure (tariff route equity) model provides for:

- a. More equitable pricing of ferries between routes; and
- b. Phasing in larger increases to provide flexibility for local communities whose sensitive economies are dependent upon ferries for the delivery of goods and services.

4c. WSF Should Recover 80% of Operating Costs from Farebox Revenue.

Under the current tariffs set by the Transportation Commission, WSF is recovering approximately 62% of operating costs. In the wake of I-695, it is necessary for the users of the ferry system to pay a larger share of the system's operating costs. The Commission should initiate a tariff increase schedule that will generate tariff revenue sufficient to recover 80% of the WSF systems operating costs from tariffs by 2007.

The subcommittee examined higher levels of farebox recovery and found that the drop-off in ridership that is likely to result from increases over 80% made the revenue producing potential of such increases questionable. The 80% recovery level optimizes farebox recovery while not resulting in inordinate ridership losses due to the effects of elasticity. Once that level is achieved, higher farebox recovery goals should be examined.

- a. Tariff increases should be phased in over six years to minimize loss of ridership (i.e. elasticity) and avoid unduly burdensome impact on ferry dependent communities.
- b. The effect on demand should be evaluated following each tariff increase. Future increases should be tailored to improve revenue gains without risking inordinate ridership losses.

4d. The Transportation Commission Should Charge a Premium Tariff for Passenger Only Ferry Service.

Passenger only tariffs should be set at double the level of passenger fares on applicable auto ferries. The passenger only program has been greatly

enhanced by the addition of two new fast boats in the last three years. This upgrade has resulted in significantly better service for Bremerton and enabled the ferries to continue the passenger- only ferry run from Vashon Island to downtown Seattle. The tariffs for this premium service are the same as passenger tariffs on the slower auto boats. Farebox recovery for these runs, however, is much lower than the farebox recovery for the auto ferry service.

- a. In recognition of the administrative advisability of proceeding in full fare increments; the fact that passenger only tariffs nationwide are more than double those currently charged by WSF; and that doubling tariffs will significantly increase farebox recovery, WSF should double tariffs for passenger-only ferries and increase tariffs on the same schedule as auto ferries thereafter.
- b. The increase should be reviewed periodically and reconsidered if:
 - The ridership drop due to elasticity threatens the viability of the program; or
 - The Bremerton passenger-only ferries are no longer allowed to run at high speed.

C. Level of Service

In response to revenue losses caused by I-695, the Transportation Commission proposed \$16 million in reductions to then existing service, labeled “bare bones”. The budget ultimately passed by the Legislature cut \$6 million, \$10 million less than suggested by the Commission. The Legislature also directed the task force to analyze and recommend: “Options for further cuts in ferry service or full or partial restoration of ferry service cuts.”

In determining an appropriate level of service, the first variable to be evaluated is the projected level of traffic. The elasticity assumptions provided by WSF indicate that one impact of moving to 80% farebox recovery will be to reduce ridership from a current total of 27 million trips per year down to 25.1 million in 2007. Only after the ridership has reacted to actual tariff increases will WSF be in a position to provide more reliable traffic projections. Given that uncertainty the Task Force decided to limit its service recommendation to the 2001-03 biennium.

In evaluating what level of service to recommend for 2001-03, the Task Force had to look at the physical limitations on WSF’s ability to adjust service: 1)

cuts below bare bones are not viable; 2) The current level of service reflects Legislative policy deliberations; and 3) service increases beyond the pre-695 level are not possible with WSF's current capital assets.

- Cuts below bare bones are not viable

If the goal of service cuts is to reduce operating costs without compromising the viability of any routes, then cuts below the Commission's bare bones level are not viable. Several routes² either break-even or come close. Further cuts on those routes would result in losing more revenue than would be saved by the cut.

Cuts on the remaining routes would have to be made in the context of collective bargaining agreements that require 8-hour shifts. Given that limitation, further cuts on those routes would have two possible results: 1) The route maintains two 8-hour shifts and WSF realizes no savings from the service cut (other than reduced fuel consumption); or 2) WSF cuts an 8-hour shift and the route is no longer viable, i.e. the ferry takes people to work but doesn't bring them back.

- Current level of service reflects Legislative policy

During the 2000 session the Legislature extensively debated how much service to cut in the wake of I-695, with several proposals considered before the final budget was adopted. The task force was mindful of the balancing of interests between ferries and other highway needs reflected in the level of service funded by the Legislature.

- WSF cannot provide service in excess of pre-2000 levels

The original 1999-01 transportation budget, passed before I-695, authorized expansion of ferry service and provided over \$100 million in capital funds to accomplish that expansion. The flip side of the coin is that service cannot be expanded beyond FY 2000 levels without investment in additional capital assets. Given the difficulty with providing sufficient funding to preserve and maintain the current capital assets, such investment is unlikely at least in the near future.

²Mid-may to mid -October Sidney route, Mukilteo/Clinton, Edmonds/Kingston and Seattle/Bainbridge

1. *Further Cuts*

The Task Force examined the cuts proposed in the Commission's bare bones budget that were not adopted by the Legislature. The Task Force's evaluation of the increment of service, cost, and number of riders is detailed below:

**Transportation Commission Bare Bones Cuts
Proposed But Not Implemented**

Route	Service	Cost of Service - Fuel at June forecast cost (\$1.100184)	Average daily ridership
Passenger only	Vashon-Seattle & Bremerton- Seattle: 16 hrs/day, Mon.-Fri.	\$5,939,442	4,770
Bainbridge	Restore 24 hour service	\$1,466,963	1,110
Edmonds	Part Time Graveyard Fall/Winter/Spr	\$640,863	680
Pt. Townsend	Shoulder service restored	\$198,687	620
Anacortes - San Juan	Add 4 th vessel (Sealth) Fall/Winter/Spr	\$1,271,595	1175
Anacortes - Sidney	Restore Sidney Service	\$81,031	180
Fauntleroy -Vashon- Southworth	Return Klahowya to FVS	(\$58,350)	-
	Restore 3rd boat service	\$1,128,530	940
Mukilteo- Clinton	Restore summer weekend nights	\$158,351	400

Considering the relatively high ridership on the runs that were not cut, and being mindful of the Legislature's policy decision to continue those runs, the Task Force decided not to recommend further cuts.

2. *Restoration of service cut*

The Task Force looked to similar data in evaluating the advisability of restoring service that had been cut. After reviewing each of the cuts the Task Force determined that restoration was not cost-effective, with two notable exceptions.

The Pt. Townsend route and the Pt. Defiance Route were subject to disproportionately large cuts that were a hardship on those populations. Other cuts made do not seem to have inflicted the same level of hardship. The route data considered by the Task Force is represented below:

Service Cut in the 1999-01 Supplemental Budget

Route	Service cut	Cost of Service - Fuel at June forecast cost (\$1.10184)	Average daily ridership
Passenger only	Weekend service	\$1,921,601	490
Bainbridge	Third vessel in summer	\$2,084,106	4,130
Edmonds	1 a.m. run Sunday - Thursday	\$589,991	55
Pt. Townsend	Summer morning & evening service	\$278,162	625
Anacortes - San Juan	Summer midnight runs Monday – Thursday	\$356,299	150
Anacortes - Sidney	January & February service	\$190,331	110
Bremerton	Friday & Saturday evening runs	\$538,419	275
Pt. Defiance	Mid-day & late night service	\$670,410	325

D. Service Recommendation:

- 5. WSF should continue to provide the reduced level of service funded in the 1999-01 supplemental budget through the 2001-03 biennium, including passenger-only service.**

WSF should stabilize service at the current reduced level, including the current level of passenger only service, for the 2001-03 biennium.

- a. Following the repeal of the MVET, the Legislature cut funding for auto and passenger-only ferry service. In response to the cuts, WSF reduced service to the level indicated by the Legislature.
- b. If the Legislature considers restoring any of the service eliminated during the last legislative session, restoration of the Pt. Townsend - Keystone and Pt. Defiance - Talequah cuts would be the most cost-effective.
- c. The total operating program cost of providing the current level of service for the 01-03 biennium is \$344 million. Approximately \$199 million of that amount is generated from user fees in the form of tariffs, leaving approximately \$145 million in operating costs to come from other revenue sources. Significant capital program costs are in addition to this amount.
- d. Future service needs should be reevaluated once WSF is able to more accurately assess the impact of tariff increases on ridership.

VI. Ferry Capital - Preservation and Improvement of Vessels and Terminals

The third subcommittee of the Task Force was the Capital Subcommittee. This subcommittee focused on the Task Force's mandate of "establishing the short-term and long-term capital needs of the Washington state ferry system". The subcommittee reviewed and evaluated WSF's capital program and, based upon the level of service recommended by the Operations and Service Delivery Options Subcommittees, developed a recommended level of capital investment.

Three interlocking goals define the mission of the capital program:

- Setting an investment level necessary to maintain the physical condition of the capital assets (terminals, vessels, and their many subcomponents);
- Setting an investment level necessary to provide the capital assets required to meet proposed service levels; and
- Incorporating one-time investment opportunities to preserve, improve, and expand existing terminals to meet current and future service demands.

In arriving at recommendations for the best investment mix to optimize these three goals, the subcommittee first researched the background of the Capital Program.

A. Background

The subcommittee examined the external requirements placed upon WSF capital investment decisions, the current condition of WSF capital assets, and the tools used for WSF's management of the current capital system.

1. *Policy-maker guidance*

The Transportation Commission, the Coast Guard and other federal agencies, and the Governor all provide goals and requirements that set the policy framework for investment decisions.

- WSF uses capital funding priorities adapted from the Governor's capital planning guidance: 1) Emergency repairs; 2) Regulatory compliance (safety); 3) Continuity of service, i.e. structural, mechanical and electrical integrity; 4) Quality of service, i.e. comfort, convenience & efficiency; and 5) Improvements to meet customer demand.
- The Transportation Commission has identified protection of existing investments (preservation) as the first priority for the WSF capital program, followed by improvements to increase capacity and mobility options.
- Federal regulatory agencies, mainly the Coast Guard (USCG), have identified vessel and terminal systems and structures that are vital for the safety of people, vessels, terminals and the environment. Generally, these are systems and structures needed to start, continue in motion, land and unload a vessel. WSF incorporates these regulatory requirements into its priorities for capital investment. WSF segregates assets into category 1-vital systems and structures and category 2-all other assets.

Starting with the Governor's priorities and matching them to the Commission goals and federal regulatory requirements yields the following priority scheme:

Rank	Governor's Funding Priorities	Matching Commission Goal	USCG Infrastructure Requirements Satisfied
1	Emergency repairs	Preservation	
2	Regulatory compliance	Preservation	Category 1 & 2
3	Continuity of Service	Preservation	Category 1 & 2
4	Quality of Service	Preservation	Category 2
5	Meet Customer Demand	Improvements	

2. *Ferry Assets*

Providing ferry services is a capital intensive operation. WSF currently operates 20 terminals, 29 vessels of various classes and the Eagle Harbor maintenance and preservation facility. The total value of WSF's capital assets is \$1 billion and has a replacement value of \$2 billion. The 2000 Legislature authorized a \$162.2 million capital budget; this was a reduction from the \$286.7 million that was authorized when R-49 revenues were available. WSF's two primary capital assets are vessels and terminals:

- Vessels: The average age of WSF's fleet is 31 years; seven vessels are more than 40 years old. The oldest vessels are the four steel electric vessels that serve the Keystone route and the San Juan inter-island route. Those vessels were originally built in 1927 and are scheduled for retirement in 2010. The newest vessels are the two passenger only vessels that serve the Bremerton to Seattle Routes. The *Chinook* and *Snohomish* were built in 1998 and 1999, respectively.
- Terminals: The average age of WSF's 20 terminals is over 30 years, with 10 terminals more than 40 years old. WSF plans to reconstruct and add multimodal facilities at the Mukilteo and Anacortes Terminals during the next ten years.

For a more detailed explanation of WSF's current capital assets, see the graphic on page 43.

3. *Management of the Existing Capital System*

The first priority for the capital program is the maintenance and preservation of existing assets. Vessels and terminals are comprised of approximately 2,600 systems and structures. WSF uses condition ratings to monitor and manage its system. A condition rating is the percentage of vessel and terminal systems and structures that are operating within their life cycles at a particular point in time.

At the beginning of the current biennium, 73% of vessels and terminal systems and structures were operating within their life cycles. Specifically, category 1-vital systems have a condition rating of 79%; category 2-other systems have a condition rating of 66%.

B. Subcommittee Tasks:

In carrying out its mandate to identify short-term and long-term capital costs, the subcommittee determined a benchmark for physical condition of capital assets; determined what level of investment is required to meet that benchmark while providing the recommended level of service; and identified additional desirable outcomes.

1. Setting an investment level for the physical condition of ferry assets.

The Task Force found that WSF's life cycle ratings for its capital assets will decline without increased investments beyond currently available revenue sources.

Recognizing the importance of safety, the capital subcommittee concurred with the Transportation Commission's proposed investment level that would generate a vital system (category 1) condition rating on 90-100%. The tradeoffs appear in the level of investment for the other systems. The Task Force decided to recommend investment at a "C+" level, i.e. 60-80% target condition rating on category 2 infrastructure. WSF's capital plan provides detailed project-level information about the investments needed to achieve the proposed condition ratings.

1. Determining the necessary level of investment

The capital investment needs of the system change if (1) service is brought below bare bones, i.e. routes are terminated; or (2) Service is expanded beyond pre-695 levels. Therefore, the threshold question that must be answered in order to determine a prudent level of investment is: How much service is WSF going to put on the water? The Task Force is recommending that WSF maintain the current level of service. Although that recommendation is limited to the 2001-03 biennium, the capital planning necessary to support it must provide a two, six and ten year plan of required investments.

The Task Force further recommends that, should the Legislature consider restoring any service cut last session, it should give priority to the cuts made on the Pt. Townsend - Keystone and Pt. Defiance - Talequah runs. Restoration of this service would not effect the level of needed capital investment. In fact, capital needs do not change appreciably within the range of service between the Commission's 2000 bare bones budget and the pre-695 level of service. WSF would be running the same boats between the same terminals, albeit more or less frequently.

One of the most expensive, and most important, pieces of the 10 year plan is the replacement of the four steel electric vessels originally built in 1927. The vessels were refurbished in the mid-1980's and are now reaching the end of their useful life, currently identified as 2010. While that may seem a long way off, there is a six to eight year time span between the decision to purchase a vessel and putting the vessel into service. See the graphic on page 44 for more detail. A commitment to replace those vessels should be made during the 2001-03 biennium to ensure that the new vessels are ready when the old vessels are worn out. The following table details the capital investment options facing the Legislature as evaluated by the Task Force.

Ferry Capital Investment Options					
		Level D	Level C	Level B	Level A
Life Cycle Preservation Cost Estimates					
Category 1 (Vital) Systems Condition Ratings		90-100%	90-100%	90-100%	90-100%
Category 2 (Other) Systems Condition Ratings		0%	50-70%	70-90%	90-100%
Preservation Cost	10 year	\$681	\$833	\$1,125	\$1,275
	Average Biennial	\$136	\$167	\$225	\$255
New Construction Cost Estimates (<i>Identical regardless of investment level</i>)					
Vessel Replacement Costs	10 year	\$317			
	Average Biennial	\$63			
Terminal Replacement Costs	10 year	\$198			
	Average Biennial	\$40			

Total Cost Estimates				
	Level D	Level C	Level B	Level A
Total 10 Year Cost	\$1,196	\$1,348	\$1,640	\$1,790
Average Biennial Cost	\$239	\$270	\$328	\$358

Estimated 2001-03 Costs For JTFF Recommended Level: \$212,987,000

On the terminal side, two major projects include both preservation and improvement aspects. The currently proposed Mukilteo and Anacortes terminal projects will replace aging structures and also include improvements that allow for future expansion.

2. *Additional Outcomes*

In reviewing the current state of the capital program, the subcommittee identified two other desirable reporting improvements:

- Outreach: In addition to determining capital investments, the subcommittee also addressed the ability to access ferry capital information. WSF keeps and provides detailed information within several documents. However, WSF information is not contained in the most commonly used legislative document: *The Legislative Project List*. This document is produced through the Capital Projects and Facilities Reporting System. WSF should include ferry capital investments in this document.
- Consistency in Reporting: WSF is defined as “Operating” and “Capital”. By comparison, WSDOT is primarily described as containing Maintenance, Operation, Preservation, and Improvement programs. WSF does contain comparable programs, they are just identified differently when receiving their legislative appropriation. WSF should repackage existing information to be displayed as Maintenance, Operations, Preservation, and Improvements.

C. **Recommendations**

6. **Short-term and long-term capital preservation requirements should**

be met in order to ensure the delivery of operating services. The Legislature should fund ferry capital such that ferry vessels and terminals can catch-up and keep-up with deferred life-cycle preservation and maintenance needs and replace aging vessels and terminals as needed.

- a. Current life cycle preservation activities do not address the replacement of assets as they reach the end of their service life.
 - i. Replacement of certain existing terminals and vessels is essential to maintaining current operating service into the future.
 - ii. New vessel and terminal construction takes many years to accomplish. In order to have new replacement vessels ready when needed, the state would need to launch the eight year vessel procurement process during the 01-03 biennium. Major terminal construction takes even longer.
- b. “Catching up and keeping up” with ferry and terminal preservation and maintenance needs means:
 - i. Raising the condition rating for category 1 capital systems to between 90% and 100% by 2011. Currently those systems are at an 82% condition rating.
 - ii. Maintaining category 2 systems’ condition ratings in the 60% to 80% range by the 2011 planning period.
- c. Meeting these goals plus existing debt obligations will require an average capital investment of between \$270 and \$328 million per biennium. This is in addition to the \$344 million operating cost identified in section III.
 - i. Preservation of existing facilities: \$167 to \$225 million per biennium;
 - ii. Replace four auto ferries scheduled for retirement: \$63 million per biennium;
 - iii. Two major terminal projects that address preservation and multimodal needs: \$7 million in the 2001-03 biennium with a \$41 million per biennium ten-year average.
 - iv. Replacement of two passenger-only boats with one new boat during the 01-03 biennium with no loss of service.

- v. New construction to replace vessels and terminals is expected to eliminate the need for \$38 million in preservation costs.
- vi. The WSF maintenance and repair facility is in need of additional investment. During the 2001 interim, WSF should review the Eagle Harbor facility and present investment options and recommendations to the 2002 Legislature.

7. The state needs to do a better job of telling citizens what they are getting for their ferry operating and capital investments.

- a. Display ferry capital investments in the same format and in the same location as WSDOT highway projects.
 - i. Format the presentations under maintenance, operations, preservation and improvements.
 - ii. Include ferry capital reporting in the transportation executive information system used by the Legislature.
 - iii. Present information in a performance based budgeting module similar to that used by WSDOT's maintenance accountability program
- b. Increase information available to the public.

VII. How Much Will it Cost?

The Task Force recommends that the WSF remain a reliable provider of waterborne transportation services to the citizens of Washington. The Task Force recommends that WSF continue to offer the current level of service and that the Legislature, in partnership with the riders, provide the funding necessary to meet those benchmarks. Earlier chapters have identified the total appropriation level required to meet these goals. This chapter provides more detail on the budget picture and identifies the net amounts that should be appropriated in the 2001-2003 biennium.

A. Revenue

The current budget structure provides revenue sources for ferry operations and capital. The largest single surviving source of revenue for ferry operations (62%) comes from the riders in the form of tariffs.

1. *Statutory revenue sources:* The primary ongoing revenue sources for WSF are:

**Current Statutory Sources of Ferry Revenue
With Projected Amounts for the 2001-03 Biennium**
in millions

	Gas Tax	Tariffs	Registration fees	Federal Funds	Total
Projected 01-03 revenue for Operations	\$34.1	\$198.9*	\$12.7		\$245.7

	Gas Tax	Tariffs	Registration fees	Federal Funds	Total
Projected 01-03 revenue for Capital	\$34.7	N/A	N/A	\$41.5	\$77.7

*Tariff revenue projection does not include fare increases.

2. *General fund operating transfer*

In response to the revenue shortfall caused by the loss of the MVET, the Legislature dedicated \$20 million per year (\$40 million per biennium) to the Puget Sound Ferry Operations account to fund ferry operations. This transfer was identified to continue until such time as the Legislature established an alternative revenue source for ferry funding.

B. Expenditures

The primary operating expenditure items are labor and fuel. About 60% of WSF operational costs are for labor. The majority of WSF's current positions (88%) are directly employed in operations and maintenance. The deployment of crew members on the vessels is largely driven by U.S. Coast Guard regulations. Of the staff assigned to vessels 97.8% of vessel staff positions are mandated by Coast Guard regulations; 2.2% are union negotiated positions.

Another major component of WSF's operating costs is fuel. The engines aboard WSF's vessels burn 21 million gallons of diesel fuel per year. The cost of diesel has risen dramatically over the last six months. The increase has caused the costs of the ferry operating program to rise significantly, further widening the gap between operating expenditures and revenues.

Capital expenditures, discussed in detail in the last chapter, are primarily driven by preservation needs.

C. The funding shortfall

Reviewing current revenue and expenditures with the assumption that WSF continues to deliver the current level of service yields the following difference between revenues and expenditures, i.e. "ending cash balance" in the last row is the difference between total revenue and total expenditures.

Ferry Operating Program : Revenues and Expenditures				
	1999-2001	2001-2003	2003-2005	2005-2007
Beginning Cash Balance	\$114,436	\$12,892	-\$41,402	-\$98,789
Total Revenues*	\$333,368	\$302,692	\$261,577	\$212,276
Total Expenditures	\$320,476	\$344,094	\$360,366	\$380,107
Operating Program Balance	\$12,892	-\$41,402	-\$98,789	-\$167,831

* Revenue projections do not include tariff increases.

Ferry Capital Program: Revenues and Expenditures				
	1999-2001	2001-2003	2003-2005	2005-2007
Beginning Cash Balance	\$ 1,713	\$ 1,600	\$ (195,642)	\$ (431,159)
Total Revenues \$	218,585	\$ 77,679	\$ 60,381	\$ 62,524
Existing Debt Service	\$ 53,711	\$ 48,675	\$ 43,768	\$ 40,113
Program Support Costs	\$ 2,989	\$ 7,759	\$ 5,541	\$ 3,328
Capital Program Costs	\$ 162,001	\$ 218,487	\$ 246,589	\$ 368,001
Total Expenditures \$	218,701	\$ 274,921	\$ 295,898	\$ 411,442
Capital Program \$	1,600	\$ (195,642)	\$ (431,159)	\$ (780,077)
Balance				
WSF COMBINED FUND BALANCE	\$ 14,492	\$ (237,044)	\$ (529,948)	\$ (947,908)

The bottom line for 2001-03 biennium:

- An operating shortfall of \$44 -84 million in operating depending on the amount transferred from the general fund; and
- A capital shortfall of \$197 million.

D. Recommended response

The possible responses to the revenue shortfall fall into two general categories: decrease expenses or increase revenue. The Task Force recommends a combination.

1. *Decrease expenses*

WSF eliminated 158 total employee positions in response to I-695. This 8.6% cut of total positions fell disproportionately on executive management and support positions (13% cut) and finance and administration positions (10% cut). In light of these cuts and the staffing level requirements imposed by the Coast Guard, it is difficult to identify areas for further labor cuts.

WSF has also undertaken other efficiency measures in an effort to cut costs. On October 6, 1998, the Joint Legislative Audit and Review Committee (JLARC) published a performance audit of the WSF). JLARC retained a team of outside auditors lead by Booz-Allen & Hamilton to undertake an audit of the activities and operations of WSF. As part of that audit, Booz-Allen and JLARC came up with 28 recommendations for improvements to WSF. The JLARC recommendations identified potential operating cost savings of up to \$6.4 million annually with a \$2.1 million initial investment.

WSF reported to the task force on the implementation of those recommendations that specifically identified potential cost saving. Of the \$6.4 million in potential savings identified by JLARC, 40% would require either a statutory change (alteration to employee COLA) or a collective bargaining change (reduce overtime rate from 200% to 150%). WSF cannot implement those recommendations unilaterally. The task force found that WSF has acted upon those recommendations that it has unilateral authority to implement and realized the available savings.

WSF must continue to implement operational efficiencies. For example, Washington State Ferries should continue to work with the region's transit systems to coordinate tariff processing equipment and media. Improvements

in traffic processing would result in better service for riders, cost savings and improved revenue tracking. New tariff processing equipment would allow WSF to implement demand pricing, i.e. tariff differentials for peak and off-peak periods.

Even with an ongoing effort to implement efficiencies, it is clear that neither staff cuts nor efficiencies alone will be enough to close the funding gap.

2. *Increase revenue*

WSF has the ability to raise more revenue through tariff increases. The task force is recommending an aggressive tariff increase schedule that will raise a significant amount of additional revenue, as detailed below:

**Revenue from Proposed Tariff Increases Moving to 80%
Farebox Recovery and Incorporating Time Based Tariff Structure
(tariff route equity)**

rate of accrual may vary depending upon how increases are phased in
(In thousands)

	2001-03	2003-05	2005-07
New Revenue - Auto	\$21,987	\$52,051	\$77,957
New Revenue - POF	\$ 2,941	\$ 4,330	\$ 5,656
Total	\$24,928	\$56,381	\$83,613

The earlier figures identifying the shortfall include the additional tariff revenue. The significant revenue increases collected through the proposed tariff increases are not, however, sufficient to cover the shortfall.

In order to keep the WSF system operating at current level, and assuming that the general fund continues to transfer \$20 million per year to the Puget Sound Ferry Operating Account, the Legislature will need to appropriate an additional:

- \$15 million for ferry operations; and
- \$197 million for ferry capital

Clearly, the ferry system is not the only transportation program facing financial difficulties at the beginning of the 2001-03 biennium. If the Legislature constructs a revenue package to address transportation funding needs, ferry system funding should be part of that package.

D. Recommendations In addition to the revenue and funding recommendations made earlier in this report:

8. Washington State Ferries must continue to adopt operational efficiencies. Implementing further efficiencies includes:

- a. Continuing to implement efficiencies proposed in the 1998 Joint Legislative Audit and Review committee's performance audit; and
- b. Investing in the technology needed to enable WSF to implement time-of-day and time-of-week variable tariffs.

VIII. Governance

A. Identification of Governance Issues

The Task Force identified the governance of the ferry system as an issue worthy of further study. At the outset, the Task Force determined that the service and revenue issues facing the system were more pressing at this time. While it did not review governance options nor make specific recommendations, the Task Force noted that the Blue Ribbon Commission on Transportation had identified transportation governance generally as an important issue to be addressed. Accordingly, the Task Force approved the following governance recommendations:

B. Recommendation

9. The Legislature should review ferry governance options. Possibilities include:

- a. The creation of local or regional ferry transit districts as a funding mechanism for the expansion of passenger-only ferry service; and
- b. Once the Legislature establishes a stable continuing funding base for the state ferry system, the Legislature could examine options for ferry governance as part of the overall review of transportation governance recommended by the Blue Ribbon Commission on Transportation.

Appendix: Minority Report

Representative Beverly Woods, 23rd District, submitted the following minority report for inclusion in the final task force report:

The Joint Task Force on Ferries had the difficult task of making funding recommendations for the operation and capital needs of our ferry service. We had to look at how we were to fund our current level of service, fund necessary expansions to our service and replace an aging fleet within the next few years.

I commend the committee, it's chairs, and it's staff for their diligent work. I agree that we need to increase the fees for service and that our goal should be to reach an equitable fare box recovery. I also agree that passenger only fares should be increased by a greater percentage than auto fares and that route equity needs to be implemented.

One of my major concerns is the six year schedule to reach the 80% fare box recovery goal. That requires steep fare increases every year for six straight years.

I am also concerned that the committee did not address all the recommendations of the 1998 Joint Legislative Audit Review Committee performance audit report.¹ There are several areas that still need to be brought to the table for discussion and resolution. Many of these recommendations, if implemented, would reduce the cost of operation considerably.

We agree that commuters should pay more of the operational costs. However, I must ask, "What is a reasonable operational cost?" I don't think that ferry commuters should pay 80% of an escalating, unchecked expense attributable to the failure to implement all necessary cost efficiencies and savings.

For these reasons, I cannot support these sections of the task force report.

¹ Joint Legislative Audit Review Committee Performance Audit Report, #98-6, conducted by Booz-Allen Hamilton, Inc., October 6, 1998.